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INTERNATIONAL DEVELOPMENT ASSOCIATION
INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
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Statement by the Hon. **MAR' IE MUHAMMAD**,
Governor of the Bank for **INDONESIA**,
at the Joint Annual Discussion

Statement by H.E. Drs. Mar'ie Muhammad
Minister of Finance, Indonesia
at the 1997 World Bank/IMF Annual Meetings
in Hong Kong, China, on September 23, 1997

Mr. Chairman, Distinguished Delegates, Ladies and Gentlemen,

This annual meeting takes place in the course of currency turmoil in the Southeast Asian region. Indeed, over the last decade, the Southeast Asian economies have demonstrated tremendous progress, a development that was described by the World Bank as *The East Asian Miracle*. Despite this progress, over the last 2-3 years Southeast Asian economies in general are marked by the following:

- high economic growth with signs of economic overheating;
- enlarged current account deficits accompanied by inflationary pressures;
- growing short term private foreign borrowings;
- construction of huge projects that are beyond the limits of national economic capacity.

In addressing these issues, the countries in the region have made considerable efforts through structural adjustments. As a result, there are positive indications that the currencies are in the process of arriving at a new equilibrium in the near future.

As far as Indonesia is concerned, we have taken the following major steps:

First, floating of the rupiah currency since the middle of August, 1997 accompanied by tightening of liquidity and increasing interest rates. This tightening is gradually being loosened, and the interest rates are being lowered in measured steps.

Second, to maintain the budget in balance, the government has decided to cut the development budget by 8.4 percent and to abolish subsidies.

Third, to boost exports and to contain imports in a GATT - consistent manner.

Fourth, deferral of a number of government projects, SOE projects, and private projects related to the government and/or SOEs, that are financed by foreign commercial borrowings and export credits. It is the government opinion that a number of private mega-projects do not reflect the national priority; therefore, they can be postponed. The postponed and reviewed projects of the government and SOEs, and the private projects related to government/SOEs, amount to approximately US\$35 billion.

The objective of these measures is to lower the current account deficit, which is now around 3.8 percent of GDP, to a maximum of 3 percent within the next two years.

Within a month of having begun to float, the rupiah has now reached a relatively stable exchange rate in the range of Rp 2,900 - Rp 2,950 per US\$, a depreciation of around 24 percent since January 1997. This relative stability is partly a result of positive reaction of the market toward the market-friendly measures taken by the government. Fortunately, this result was achieved without sacrificing our foreign exchange reserves.

Despite the budget constraints that we are facing, the Government of Indonesia reaffirms its commitment to discharge all of its financial obligations fully and timely, and will continue to make efforts to prepay our foreign debt using proceeds from on-going privatisation of our SOEs.

Although we are in favor of market mechanism, we are concerned with the excessive volatility of many currencies which undoubtedly creates uncertainties in the business community, and in turn could lead to an economic crisis. In this regard, I would urge the IMF to take an active role according to its mandate.

Meanwhile, we are impressed by, and we support, the recent approach of the World Bank in implementing the development concept in a very broad sense. We welcome the initiative taken by the World Bank and IMF in addressing the foreign debt

burden of the most severely indebted poor countries. As part of our commitment to the HIPC Initiative, the Government of Indonesia has decided to contribute US\$10 million to the HIPC Trust Fund. Considering that around 1.3 billion persons still live in poverty, we urge the Bank to put poverty eradication program as its highest priority.

In my view, the goal of development is to create conditions that will enable each human being to attain his or her potential in all aspects of their lives, in creating a sound society which succeeds in preserving the harmony between community and individual interest and in maintaining the balance between rights and duties.

Finally, I wish to state that Indonesia will continue to maintain the sound and prudent economic policies that have been demonstrated over the last 30 years, and we will continue to carry out effective structural reforms.

Since excessive volatility of currencies can hinder the world economy, we warmly welcome any regional or global initiatives to stabilize currencies.

Thank you.

Government Statement
on
Policies to Deal with the Impact of
Rupiah Fluctuations
Indonesian Parliament Plenary Session
September 16, 1997

Mr. Chairman and Honored Members of Parliament:

We would like to open the statement by inviting the Chairman and honored members of Parliament to give praise and thanks to God Almighty, as only with His blessing and mercy will we have the strength to fulfill our duty to our nation.

In the State Address delivered to the Indonesian Parliament by the President of the Republic of Indonesia, on August 16, 1997, the President set forth the reasons why Indonesia had decided to allow the rupiah to float. Further, in the same address, a broad indication was given of the policy direction which would be followed by the Government to deal with the impact of the floating of the rupiah that occurred after intervention band was suspended. Experience from other countries has shown that in the early stages of a floating exchange rate system, substantial fluctuations in the value of the currency will take place. This fluctuation is generally short-lived and is caused largely by market players and persons who are in process of learning how to deal with the new reality. This initial condition can be exacerbated by speculations. Moreover at this early stage the currency is still in the process reaching a new equilibrium.

Even though in the early stages of a floating exchange rate system there is likely to be excessive volatility, we note that since the beginning of September the rupiah has been relatively stable with the exchange rate moving between Rp. 2900/US\$ to Rp. 2950/US\$. This favorable outcome reflects various Government efforts that were positively received by the market.

Honored Members of Parliament,

The currency fluctuations have had a substantial effect on business activities as well as on our national development programs. The changing value of the rupiah has influenced government receipts as well as the forecast annual expenditures in the State Budget for 1997/1998. Even though there is a considerable negative impact, we hope this event can be used as an opportunity to consolidate the national economy by implementing various structural adjustments. These structural adjustments are needed so that all sectors of our national economy are prepared to face economic globalization, a development that is already well under way.

The South-East Asia currency fluctuations occurred at the same time as the American dollar gained strength against most other currencies, including the Japanese Yen and to the European currencies.

Mr. Chairman and Members of Parliament,

From January 1997 through 11 September 1997 the rupiah depreciated by 23.53%, while the Thai Baht has depreciated by 36.68%. The weakening of the rupiah/dollar exchange rate should be seen in light of the weakening of several currencies in South-East Asia, as well as the Japanese Yen and other European currencies against the American dollar. This change in the exchange rates was important if Indonesia was to maintain its competitiveness, since in addition to the United States, Japan and Western Europe are also important markets for Indonesian exports. One difference between what happened in Indonesia and elsewhere is that Indonesia's depreciation took place without any substantial loss of our national foreign exchange reserves.

In order to stabilize the fluctuations of the rupiah and to assist in the strengthening of the national economy as soon as possible, the Government will undertake a series of policy measures with the following objectives:

- (1) To stabilize the value the rupiah at a new equilibrium level;
- (2) To strengthen fiscal policies;
- (3) To reduce the current account deficit;
- (4) To establish a sound banking sector;
- (5) To create a vibrant private business sector.

To reach our goals we will take steps that are in line with the new situation and with market trends. These measures will have a positive effect on the development of the capital market and are in line with Indonesia's 25-year reputation for prudent economic management.

Mr. Chairman and honored members of Parliament,

To reach the above mentioned goals, the Government is already implementing a number of policy steps and will take further measures as follows:

- (1) As the situation permits, the Government will continue to reduce interest rates on SBIs, in stages. The reduction of interest rates on SBIs will help to bring down interest rates on loans. This is important for promoting the recovery of the private business sector.
- (2) The government will loosen liquidity gradually and in accordance with the situation through fiscal and monetary instruments. This easing of liquidity will be conducted cautiously so as not to give rise to additional volatility of the rupiah.
- (3) Because government revenue from direct and indirect taxes is going to decline, an adjustment to government expenditure is needed. The reduction in receipts is due to a reduction in private business activity and to numerous losses experienced by private businesses as a result of the change in the exchange rate. The state budget is also under pressure because of the size of the fuel (BBM) subsidy, currently borne by the government, that has resulted from the decline in the value of the rupiah. The fiscal year 1997/98 budget originally planned for a net profit from oil of Rp 249.2 billion. However, if the reference price of US\$ 16.5 per barrel of oil is maintained and if the exchange rate is US\$ 1 = Rp 2,900, the size of the annual BBM subsidy

rises to Rp 2.2 trillion. If necessary adjustments are not made, the state budget for the current fiscal year will suffer a deficit of Rp 9.2 trillion, and for this reason steps must be taken to overcome the potential deficit.

Therefore, a number of budget programs and projects should be rescheduled, including:

- (a) Programs/Projects of various Ministries and Government Institutions;
- (b) Official travel;
- (c) Workshops, Seminars, and Training;
- (d) Land Acquisitions, Government Office Constructions, and Procurement of Equipment;
- (e) Other development projects under Part XVI of the State Budget.

The total amount of expenditure to be rescheduled comes to Rp 3,278.9 billion. This is equivalent to 12.7% of the rupiah development budget or 8.4% of the total development budget.

Projects to be rescheduled within the Ministries and Government Institutions consist of those projects where a significant portion or all rupiah financing is used for import, those projects that have not yet begun any physical development, or those projects that have not signed the contract. Most of these projects are within the Ministry of Public Works, Ministry of Mining and Energy, and Ministry of Transportation.

Although we are experiencing constraints on the state budget, the government will fulfill its foreign debt obligations thoroughly and on time. If the situation permits, it may even be possible to make prepayments on foreign debt.

- (4) Various programs and projects that are directly connected to efforts to raise social welfare and overcome poverty will not be rescheduled. These programs and projects will be carried out as planned. Included in this category are various Inpres projects, the IDT program, and projects in the field of basic health and basic education. In addition, foreign aid projects whose funding source is from the CGI, will be carried out as planned.
- (5) In addition to budget projects, various state-owned enterprise projects will be postponed or reviewed, primarily those with high import content or those funded from overseas. Projects that will be postponed or reviewed include:

- a. Government projects;
- b. State-owned enterprise projects;
- c. Private projects connected to the government;
- d. Private projects connected to state-owned enterprises whose funding source is from:
 - (i) Foreign commercial loans that require the approval of Tim PKLN (Keppres No. 39/1991);
 - (ii) Export credit.

Such projects are divided into three categories, namely: those that will be continued, those that will be postponed, and those that will be reviewed. Projects to be continued are those that are already under construction. These projects will be continued according to the original schedule. Projects to be postponed are those projects that have not yet begun. Implementation of these projects can be postponed until the economy recovers and the objectives of this rescheduling have been achieved. Projects to be reviewed are those projects that require further study and based on the results of the study these projects will be either continued, postponed or rescheduled.

From the total number of state-owned enterprise projects and private projects connected to government/state-owned enterprise that are financed with commercial credits amounting to Rp 161.78 trillion, those to be postponed amount to Rp 38.92 trillion (24.1%) and those to be reviewed amount to Rp 62.69 trillion (38.7%). Within the Ministry of Mining and Energy, of the 29 Power Generating Plants that have been negotiated, 14 of those will be postponed amounting to US\$ 5 billion, and 9 of those will be reviewed amounting to US\$ 4.9 billion. Furthermore, two oil refinery projects amount to US\$ 800 million will be postponed. Within the Transportation Sector, 29 toll road projects will be postponed, and 19 toll road projects will be reviewed. The Manggarai Terminal project and the Surabaya-Madura Bridge project will be postponed.

In addition, various private mega-projects such as Menara Jakarta and the Java-Sumatera Bridge project are not considered to be priority projects by the government, and therefore can be postponed. So can the Indonesia-Malaysia Bridge project, which is not an urgently needed project.

From government development projects financed with export credits amounting to Rp 2.37 trillion, those to be postponed amount to Rp 237.6 billion (9.4%) and those to be reviewed amount to Rp 970.1 billion (38.2%).

The desired outcome from postponing and reviewing the projects mentioned above is to reduce the current account deficit, so that over the next two years the current account deficit can be kept to a maximum of 3 percent of GDP.

- (6) To stimulate non-oil exports, the government will provide facilities to exporters mainly in the form of pre-shipment financing. In addition, import duties on a number of raw materials and intermediate products will be reduced.

- (7) To further restrain the growth of imports, the government will impose and increase sales taxes on a number of luxury consumption goods (PPn BM) that are not vital for development or for basic social needs.
- (8) Consolidation and measures to improve the soundness of the banking system will continue to be carried out. Within this framework, a study on the plan to merge state banks is being completed and will be implemented as soon as possible. It is hoped that plans for the merger and acquisition of private banks will continue. Banks that are truly insolvent and whose difficulties cannot be overcome through merger or acquisition will be liquidated, while safeguarding depositors as far as possible, mainly small depositors.
- (9) Private businesses are encouraged to engage in consolidation and not to pursue unnecessary expansion activities, especially those activities that depend on short-term foreign funding. In this connection, the government also hopes that private companies will fulfill their obligations toward foreign parties.

Mr. Chairman and honored Members of Parliament,

Realizing that dealing with currency volatility requires regional and even global efforts, the Government welcomes every effort aimed at stabilizing the various foreign exchange rates, including those in Southeast Asia, through a process of regional and global cooperation.

The Government will implement these measures as quickly as possible in order to provide greater certainty for the private business community and for society in general.

The Government seeks the support of the honorable members of Parliament in these efforts and extends its appreciation for this support.
May God the Almighty bless our efforts.

On behalf of the Government

Minister of Finance

Mar'ie Muhammad